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SUBJECT: MADRID WEEKLY ECONOMIC UPDATE - OCT 13-17

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GOS, Following Eurozone Lead, to Guarantee Bank Borrowing

11. (SBU) President Zapatero announced October 13 that the GOS will guarantee up to 100 billion euros in bank borrowing this year. This initiative is part of a decree approved that day by the Council of Ministers that incorporates measures agreed over the weekend by heads of state of the euro nations. The decree also includes a "preventative" clause allowing the GOS to buy equity in banks if necessary. Zapatero echoed Second Vice President and Economy/Finance Minister Solbes' October 12 statement that he did not think any Spanish banks would need the GOS to purchase equity. Perhaps heeding criticism that he has been overly optimistic during Spain's growing economic difficulties, Zapatero said that the recovery of economic activity would take time and effort, because the situation was "very grave." In a Congressional hearing the following day, Zapatero warned of likely mergers or restructurings of smaller Spanish banks and savings banks (cajas). (Embassy, All Media, 10/14/08, 10/15/08)

President Zapatero and Opposition Leader Rajoy Discuss Economic Measures in Historic Meeting

12. (U) During a historic meeting October 14, President Zapatero and opposition Partido Popular leader Mariano Rajoy discussed measures to address Spain's flailing economy. Zapatero and Rajoy's relationship to date has been characterized by partisan and bitter exchanges, especially regarding the state of the economy. During this rare coming-together, Rajoy conditioned his support for Spain's

financial markets measures on greater oversight on the 100 billion euro inter-bank loan guarantee fund and the 30-50 billion euro asset/equity fund (ref). Zapatero agreed to Rajoy's demand, committing to greater transparency, rigor, and oversight. The two leaders also agreed to work together over the next two months to develop a bi-partisan plan on economic structural reforms, an area in which the two parties have traditionally been at odds. Despite these significant agreements, Rajoy and Zapatero continued to be in opposition on the 2009 proposed budget. Zapatero's public statement after the meeting was one of optimism, Rajoy's was one of cautious expectations. (El Pais, 10/15/08)

Economic Status Update - Inflation down, but Housing Market Still a Problem

13. (U) Economic information from the past week (October 13-17) indicates that Spain's economy continues to face significant challenges. According to Spanish real estate appraisal company TINSA, the glut of unsold new properties from Spain's housing bubble will likely reach 930,000 by the end of 2008, a level much higher than earlier anticipated. Related to the residential construction market, cement consumption is down from the year before by 25% in the first 9 months of 2008. In a radio interview October 16, Minister of Labor Celestino Corbacho stated that negative job growth will continue to occur in the upcoming months (latest estimate for Spain's unemployment rate is over 11 percent). In more upbeat news, the National Institute of Statistics reports that Spain's September inflation rate (CPI) decreased by -0.4 from the year before to 4.5%. GOS expectations are that this rate will continue to decrease over the upcoming months, ending the year at 3.5%. (El Pais, Confidencial, Cinco Dias, 10/14/08-10/17/08)

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Chairman of Spain's Largest Bank Speaks Out on Financial Market Turmoil

14. (U) According to Emilio Botin, Chairman of Banco Santander, the financial market crisis is a manifestation of various excesses and cannot be blamed on any one market (such as the U.S.) or on any one cause. This assertion, publicized widely in the Spanish press, is being portrayed as a contradiction of President Zapatero's statement blaming the U.S. for the current economic malaise. Botin praises the actions of the Spanish government and eurozone leaders, but repeats the message of Second Vice President and Minister of Economy Pedro Solbes in saying that Spanish banks are faring well and do not need the GOS to take ownership stakes as other governments have done. Botin also emphasizes the importance of liquidity, avoiding moral hazard, and reinforcing transparency and supervision. Comment: Botin has a strong standing in Spain, and any comments made by him carry significant weight in the local arena. His comments were taken from a recent speech and an opinion piece he wrote in the Financial Times. (All Media, 10/16/08, 10/17/08)

Santander to Buy Remaining 75% of U.S. Bank

15. (U) On October 13, Banco Santander announced that it would purchase the 75% it did not already control of the Pennsylvania-based Sovereign Bank. The purchase will be carried out by a stock swap of several billion euros. Santander had paid about \$2.4 billion for its previous stake in Sovereign, plus a \$1 billion capital increase earlier this year. Sovereign has suffered from poorly performing mortgages and auto loans and the government takeover of Fannie Mae and Freddie Mac, in which it held stock. It has 750 branches and 12,000 employees in the northeastern U.S. (El Pais, 10/14/08, 10/14 Santander press release)

Spaniards Affected By Lehman Brothers Bankruptcy Protest Spanish Banks

¶6. (U) On October 13, between 50-100 protestors gathered in front of Spain's central bank (Bank of Spain) to demand an investigation into Spanish banks for selling Lehman Brother's bonds to low risk profile investors and not mentioning these investments. Earlier in September, the Bank of Spain had asserted that Spanish banks had minimal exposure to Lehman Brothers and remained healthy. However, recent news about Banif's exposure, which some speculate is as high as 800 million euros, has caused concern about the health of that particular bank. (El Pais, 10/14/08; Confidencial, 10/17/08)

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